

January 24, 2023

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue

Re: Comments on Principles for Climate-Related Financial Risk Management for Large Financial Institutions, Docket No. OP-1793

Dear Board of Governors,

We are writing today with comments in response to your recently-issued Principles for Climate-Related Financial Risk Management for Large Financial Institutions. We write on behalf of Impax Asset Management, a specialist manager focused on investing in the transition to a more sustainable economy.

In our view, the Principles are well conceived, thorough, and should be beneficial to participants in US financial markets. Climate change presents a wide range of financial risks to specific companies and their investors, as well as systemic risks to the economy as a whole. The Principles will contribute to a more robust understanding of the impact of climate change on financial institutions, markets and the broader economy than exists today.

In particular, we commend the Board of Governors for the following requirements:

- Including both transition and physical risks. The focus on physical risk in particular is essential to managing systemic risks.
- Recognizing the importance of disruptions to infrastructure in reporting on operational risk.
- Specific mention of the impacts of climate change, and management of climate risks, on low- to moderate-income households and communities. Social unrest and conflict can in turn drive systemic risk.
- Recognition of the evolving nature of climate risk. There are new additions to the repository of climate science every day, and while what we already know is sufficient to stimulate action, we should continually adapt to new knowledge of climate risks and impacts.
- Requiring accountability for the management of climate risks, and recognizing the related but different roles of board and executives in managing climate risks.
- Requiring scenario analysis and reporting on impacts across a range of plausible scenarios and under various time horizons, from short- to medium- to long-term. Financial markets are often myopic, and management of climate risks cannot be adequately accomplished in the short term alone.

We suggest the following for you to consider in the final rule.

- The draft notes that boards should consider whether incorporation of financial risks into strategy warrants changes to compensation policies. **We suggest that the rule should consider specifically naming long-term compensation.** Often, linking any sustainability-related performance to executive compensation has affected only salary and bonus, and these links may be insufficient to achieve real progress.¹ Long-horizon incentives, on the other hand, have demonstrated benefits for both stakeholders and shareholders.²
- The emphasis on planning for the purpose of managing climate risks is appropriate. **Adaptation to climate risks should be recognized as an appropriate tool for managing risks.** We believe that corporate action to substantially reduce emissions is an imperative for all firms. Companies need to prepare simultaneously for more extreme and variable weather. As an example, one company moved manufacturing operations away from Houston after irreparable damage to its facility from Hurricane Harvey, recognizing the site's vulnerability to future flooding.³
- In addition to the draft rule's proposal for creating accountability for managing climate risks, we suggest that companies **also report on how their board and management acquire the needed expertise to understand and manage climate risk.** That expertise may be in the skill sets of existing board members and managers, or through consulting arrangements or other outside experts.
- We believe that one of the most effective ways to help establish accountability for climate transition risk management is for major financial institutions **to report on financed emissions.** While some major banks have made pledges to phase out financing of fossil fuel production, there are often not comprehensive and are often viewed skeptically.⁴ We also suggest that the Federal Reserve establish a reporting framework to cover all major sources of financed emissions to avoid the severe gaps in current reporting by financial firms.
- The rule is commendable for requiring that financial institutions should "assure that any public statements about their institutions' climate-related strategies and commitments are consistent with their internal strategies and risk appetite statements." We believe that this **be extended to financial institutions' lobbying spending, political contributions, and dark money contributions to nonprofits active in the climate policy debate.** Especially after the Supreme Court's decision in Citizens United held that corporate spending is a recognized form of free speech,⁵ it is

¹ CJ Clouse, "Does linking ESG performance to executive pay actually make a difference?", GreenBiz, February 2, 2022. [Does linking ESG performance to executive pay actually make a difference? | Greenbiz](#)

² Xudong Fu, Rui Shen, Tian Tang, and Xinyan Yan, "Horizon to Sustainability: Uncover the Instrumental Nature of Corporate Social Responsibility," Social Science Research Network, 17 March 2021. [Horizon to Sustainability: Uncover the Instrumental Nature of Corporate Social Responsibility by Xudong Fu, Rui Shen, Tian Tang, Xinyan Yan :: SSRN](#)

³ Cara Smith, "After Hurricane Harvey flooding, HP moves some manufacturing from Houston to Austin," *Austin Business Journal*, Jan. 17, 2018.

⁴ "COP26: Banks' net-zero pledges ignore most fossil fuel financing," S&P Global Market Intelligence, 28 Oct. 2021. [COP26: Banks' net-zero pledges ignore most fossil fuel financing | S&P Global Market Intelligence \(spglobal.com\)](#)

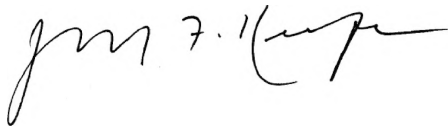
⁵ John Geary, *The Dark Money of Climate Change*, ESSAI Volume 17, Article 17, Spring 2019. [The Dark Money of Climate Change \(cod.edu\)](#)

important to include these forms of political influence spending in the assessment and reporting of strategies relating to climate risk.⁶

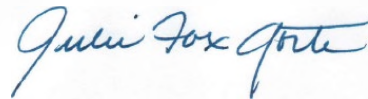
- It might be helpful to **require reporting on specified climate scenarios, such as RCP 4.5 and RCE 8.5**, in corporate risk identification described on p. 11 of the proposal. Several institutions do specify named scenarios for simulating the impacts of physical risk.⁷
- While the proposal requires reporting on credit risk, liquidity and financial risk, operational risk, and legal/compliance risk, there is one increasingly important element that is arguably missing. We suggest that the rule **require reporting on defaults and default risk in loan portfolios resulting from physical risk**. The probability of default is heightened, especially for high yield debt, by climate change,⁸ as is credit risk, which could result in reduced ability to pay among borrowers.⁹

Again, we appreciate the Federal Reserve's thoughtful crafting of this proposed rule, and we appreciate the opportunity to comment.

Sincerely,



Joseph F. Keefe
President
Impax Asset Management



Julie Fox Gorte
SVP for Sustainable Investing
Impax Asset Management

⁶ Ciara Torres-Spelliscy, "More Shareholders Seek Transparency on Corporate Political Spending and Climate Change," Brennan Center for Justice, June 16, 2021. [More Shareholders Seek Transparency on Corporate Political Spending and Climate Change | Brennan Center for Justice](#)

⁷ CDP Climate Change 2022 Reporting Guidance, CDP, 2022. [Climate Change - CDP](#); and Bank of England, Guidance for participants of the 2021 Biennial Exploratory Scenario: Financial risks from climate change, June 2021. [Guidance for participants of the 2021 Biennial Exploratory Scenario: Financial risks from climate change \(bankofengland.co.uk\)](#)

⁸ Reka Janosik and Thomas Verbraken, "How Climate Change Could Impact Credit Risk," MSCI, Oct. 20, 2021.

⁹ Basel Committee on Banking Supervision, "Climate-related risk drivers and their transmission channels," April 2021. [Climate related risk drivers and their transmission channels \(bis.org\)](#). See also Mark Segal, "ESG Issues to Increase Credit Risk in 2023: Moody's," *ESGToday*, January 10, 2023, [ESG Issues to Increase Credit Risk in 2023: Moody's - ESG Today](#); and Parker Bolstad, Sadie Frank, Eric Gesick, and David Victor, "Flying Blind: What do investors really know about climate change risks in the U.S. equity and municipal debt markets?" Brookings Institution, September 16, 2020. [Flying blind: What do investors really know about climate change risks in the U.S. equity and municipal debt markets? \(brookings.edu\)](#)